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Economic Conditions Governmental Finance United States Securities

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General Business Conditions

THE month of July has borne out the promise of better business conditions contained in the reports for June. The action of the stock market in breaking out of the rut on the up side, with greatly increased volume of trading, has been a cheering development, regarded by many as confirming the view that the Spring recession had run its course, and that business is once more moving ahead. It is recognized, of course, that the hazards are still very great, and few business men are venturing to set their sights very far ahead; nevertheless, feeling is undoubtedly better, and this in itself is a change of importance.

For the rise of security prices, ample explanation may be found in the better-than-seasonal performance of leading business indices during the past two months. It is true that the trend in June had pointed to an absence of the usual Summer slump, but apparently some skepticism remained until the recovery after the July 4th holiday was definitely established. The steel industry, of course, has been the outstanding example of counter-seasonal improvement, mill operations rising in the latter part of July above 60 per cent of capacity, the highest since last November. However, a quickening of business has been noted in other lines as well, including not only consumption goods, but also non-ferrous metals, electrical equipment, machinery and chemicals. With the figures for June largely complete, the Federal Reserve Board's index of industrial output rose 5 points in that month to 97, and from all indications will be as high, if not somewhat higher, in July.

With July the month when buyers come into the central markets from all over the country to place their preliminary orders for the Fall retailing season, the response to Summer wholesale shows is always followed with interest; and here, too, the results have been encouraging. Indications have pointed to liberal covering of early Fall needs, though evidently buyers are remaining conservative as to the later months of the year. Inasmuch, as retail inventories, from all reports, are lower, both actually and relative to sales, than a year ago, there should be further replenishment of stocks as the season progresses, assuming, of course, no unexpected drop in retail sales. This should afford continuing support to the consumer goods industries.

Other Factors of Encouragement

Contributing also to the improvement in sentiment, and reflected in higher security prices, has been the showing of corporation profits for the second quarter and for the half year now coming to hand, and summarized in later pages of this Letter. Many of these proved to be better than had been generally looked for, and bear witness in an impressive way to the high operating efficiency of American industry and to the ingenuity of management in reducing costs and translating modest gains in operating rates into more satisfactory results in profit and loss statements. Although the upturn that has taken place still leaves profits for most companies well below the level reached prior to the 1938 slump, nevertheless, the fact that business has been able to do as well as it has under the circumstances has been distinctly heartening to business men and investors, especially in view of the prospect of a more profitable rate of operations during coming months.

Along with the improvement in business volume and profits, sentiment has been aided by a number of developments in Washington, including the enactment by Congress of the new Revenue Act, sponsored by the Treasury Department, which eliminated the undistributed profits tax, liberalized taxation of corporate capital gains and losses and improved the corporate tax system in other respects.

The proposal, likewise supported by the Treasury, in the pending amendments to the Social Security Act to freeze payroll taxes at the present level of 1 per cent on the employer and a like amount on the employee, dropping the ½ of 1 per cent increase now scheduled to go into effect automatically on January 1,

is pleasing to business, already heavily burdened by taxation. In the utility field, the action by Congress in limiting a proposed bond issue by the Tennessee Valley Authority to the amount needed to carry out the pending purchase agreement with the Tennessee Electric Power Company, was welcomed as diminishing somewhat the threat of further government competition with the private companies. Other actions by Congress generally viewed as significant included the elimination of the "prevailing wage" provision in the new Relief Act, and the resolution by the House to investigate the National Labor Relations Board, long an object of criticism by industry on the grounds of unfair administration of the Wagner Labor Act.

Apart from any direct benefits to industry from action along these and other lines, the evidence of Congressional willingness to give sympathetic hearing to the point of view of business has given new courage to business men and undoubtedly has been a factor in the better feeling prevailing.

The Decline of Agricultural Prices

While prices of industrial raw materials have held generally firm, and in some instances have advanced, a disturbing feature of the month has been the weakness of the principal foodstuffs, corn breaking to below 40 cents at Chicago for the first time since 1933. Wheat dropped to new seasonal lows in Chicago and in Liverpool made all-time record lows on the outlook for another increase next season in world supplies, already at record high levels. Hog prices were likewise weak, on prospects for a 15 to 20 percent increase in slaughter next Fall.

In estimating aggregate farm income, however, it must be borne in mind that prices of both cotton and wool, which are important products, have held up. Moreover, allowance must be made for government soil conservation and parity price payments, plus government loan privileges. The wheat loan has been fixed at 80 cents a bushel at Chicago, and it is expected that the corn rate will be not less than the present rate, 57 cents on the farm. Thus present prices do not accurately reflect what the farmer may realize on his crop, which will be much more than the markets indicate.

In the July review of the agricultural situation, published by the United States Department of Agriculture, and received at this office on the 24th, the Department states that farm income is expected to total about the same this Summer as last, and observes, further, that "there is a possibility that income from products that move directly into consumption may increase slightly more than usual during the Summer months, especially if there is an increase in industrial activity and consumer incomes."

In the eastern and northeastern States, a severe drought caused concern for crops, but substantial relief came with rains late in the month. Generally throughout the country, the crops have made good progress, and the corn crop outlook is exceptionally good.

An important market development of the month has been the announcement of a subsidy of 1½ cents per pound on cotton exports which went into effect on July 27. This subsidy is an extension of the policy under which an assisted exportation of wheat has been carried on during the past year, as referred to in our June Letter. The proposal for a cotton subsidy has been before Congress for some months, and both domestic and foreign prices have been so influenced by it that no violent effects have been felt, whatever the ultimate effects may be. Exports of cotton from this country from August 1, 1938 to July 27, 1939 aggregated 3,346,000 bales against 5,672,000 bales in the full year, August 1 - July 31, 1938, and 5,511,000 bales in the corresponding period, 1936 - 37. The cotton exports of the year just closed have been the lowest in fifty-six years. Plainly nothing less than a calamity has befallen what has been our chief export commodity over more than 100 years.

The wheat and cotton subsidies are explained by Secretary Wallace as intended to relieve excessive supplies in the home market, and to maintain our "historic and rightful position in the world markets." This, however, invites the response that we voluntarily abandoned the foreign field by holding our cotton out of foreign markets until other countries had been induced to increase their supplies, and are now attempting to recover the lost position by practices which we ourselves have pronounced unfair. Comments of this kind have been made and will have to be met at the International Cotton Conference which Secretary Wallace has called to meet in Washington next month.

Conditions in the Industries

We have referred earlier to the rise of steel mill operations above 60 per cent of capacity. Despite the rapidity of the rise in recent weeks, output apparently has been running not much in excess of demand. Aside from some production anticipating automotive needs, the rate has been sustained by structural and engineering requirements, along with steady miscellaneous steel buying. Strength and activity in the scrap markets supports expectations that the production rate will be well maintained in coming weeks.

Automotive production is experiencing the usual slowing down preliminary to the shift to new models, and August is expected to be the low month of the year. For the month of June output totaled 310,000 units, and domestic deliveries about 290,000 units, gains of 77 and 55 per cent, respectively, over the

corresponding month last year. With retail sales in recent months holding very satisfactory levels, dealers have been able to reduce stocks, so that the industry enters the new season in good shape statistically, — especially so as regards used cars. The chief factor now causing concern is the strike of the General Motors tool and die workers, which delays work on the 1940 models. According to figures recently released by the Automobile Manufacturers' Association, production of motor cars in 1938, despite the sharp rise in the fourth quarter, fell just short of filling the replacement demand, a condition experienced previously only in the years 1931 through 1933. The effect, however, was to leave all the more room for expansion in 1939.

The non-ferrous metals, often regarded as a barometer of industrial activity, have been active and firm. During June domestic sales of copper, exceeding 66,000 tons, were the largest since last October, and in July sales increased to more than 180,000 tons, the best since October, 1936. The heavy demand is a reflection both of low inventories in the hands of fabricators and of increased demand for finished products. Prices were marked up 1/4 to 3/8 of a cent to 10 1/4 - 10 3/8 cents, Connecticut Valley. As a result of increased business, the statistical position of copper has improved substantially. Domestic stocks, which at the end of June were reported at 335,000 tons, have been reduced, and the amount unsold apparently is now close to the normal three months' supply. An indication of the tight situation in the foreign copper market was the placement by the French Government of half of an order for 50,000 tons in this market, in order to get July-August delivery. Domestic sales of lead and zinc have continued in good volume, with prices steady.

The value of building contracts awarded during the first three weeks of July, on a daily average basis, was slightly greater than in June, and 26 per cent above the daily average in June last year. Residential contracts were off seasonally compared with June when they were the largest for any June since 1929, but continued to run above a year ago, though naturally the margin has narrowed because of the rising trend in the last half of 1938. Building materials manufacturers, who were late in feeling the increase in building this Spring, are now reporting better business.

In the lighter industries, the reports on the whole have been favorable. Cotton mill activity has risen to new high levels for the year, increased production in other lines more than offsetting the curtailment in print cloths. Operations in the latter division have been curtailed 25 per cent for July, August and September which, together with another buying movement in the textile market, has enabled mills to lighten their heavy stocks of finished goods, and the statistical position of the goods market has strengthened. Textile prices in the primary markets have firmed up, and mill margins, which have been unsatisfactory, have improved somewhat. Woolen mills are active on Fall lines, with unfilled orders well above a year ago, and prospects for above normal operations until Fall. The rayon industry is also busy but silk consumption has fallen off owing to the high price of raw silk. Shoe manufacturers have gone into production on Fall lines earlier than usual, having received a good volume of initial orders.

Retail trade is being maintained at levels well above a year ago, with mail order houses in the lead, showing gains of 15 to 24 per cent over last year. Railway car loadings and electric power consumption made new highs for the year in July, latest figures rising 13 and 10 per cent, respectively, over 1938. Power consumption is approaching the all-time record reached in 1937.

The Outlook

All in all, business appears to be moving forward in a gratifying manner, and, barring an upheaval in Europe, it is difficult to foresee any basis for serious setback for some months at least. From all accounts, inventories generally are in sound position, business is proceeding with caution, and industrial costs, while high, are not rising over any broad area. During the Fall months the seasonal pickup in motor car manufacturing will be giving important support to business.

In sizing up the Fall prospects, a factor to be reckoned with will be a further mandatory raising of minimum wages and shortening of hours, under the Wage-Hour law, to take effect October 24. The effect of this will be felt principally in the smaller industries and in industries employing a large proportion of unskilled labor, as the wages and hours in the mass production industries are already for the most part well within the provisions of the law. Indeed, it seems that a tendency of the law is to make big industries bigger and the small industries smaller; also to speed the displacement of labor by machines.

Despite the reduction of W.P.A. expenditures, the total of government spending will apparently remain high during the Summer and Fall. This continued high rate of spending and the uncertainty as to the extent to which business has been made dependent upon it, continues to be a chief source of anxiety.

Money and Banking

Bank reserves and deposits continued to increase during July. For all member banks of the Federal Reserve System, the increase in reserves amounted to more than $300,000,000, establishing a new peak at $10,436,000,000, and approximately 4 1/2 billions in excess of legal

requirements. In the case of deposits, figures available through July 19 for the weekly reporting banks showed demand deposits "adjusted" up $170,000,000 in three weeks to a level which was also higher than ever before.

Accounting in part for the further growth of reserves and deposits was the addition of $134,000,000 to the country's mounting gold holdings, now totaling in excess of $16,200,000,000. For the rest, an important factor was a drop of over $200,000,000 in the Treasury's cash balances in Federal Reserve Banks which would have been greater but for the action of the Treasury in replenishing these balances by the deposit of gold certificates issued against "free" gold in Treasury vaults. For several months the Treasury has been drawing on its "free" gold stock for this purpose, thereby reducing the total from around $700,000,000 in February to just above $500,000,000 as of recent date (both figures including approximately $142,000,000 of unused "profit" from the devaluation of the dollar in 1934).

At the weekly reporting banks, a noteworthy change was a moderate rise in loans for business purposes. This amounted to $70,000,000 in the four weeks ended July 19, and lifted the total somewhat above levels previously touched this Spring. Probably a good part of this rise was due to the placing of term loans, which represent in part refunding of outstanding securities and therefore not new money. Loans to brokers declined to a new low for the year; and banks, in consequence of the scarcity of suitable loans, continued to seek outlets for their funds in the security markets. In July holdings of United States Government issues reached a new peak since the Summer of 1936.

With the credit reservoir rising higher than ever, interest rates for short-term funds continued largely nominal, the average discount basis of the Treasury's weekly bill offerings ranging from 0.012 to 0.019 per cent. On account of the shortage of bills, the Reserve Banks allowed a further portion of their bill portfolio to mature without replacement, thus reducing the total since the latter part of June by about $75,000,000.

In the bond market, prices of high grade issues were generally steady under the influence of high money supplies, with second grade corporation bonds moving upward to the accompaniment of improved business reports and higher stock prices. Certain of the railroad issues responded to enactment by Congress of the Chandler bill, providing for voluntary capital readjustments of railroads facing reorganization under Section 77 of the bankruptcy act. Prices of long-term Government issues fluctuated narrowly, highest prices being made at the end of the month when the long-term bond issues sold within half a point of the record points reached in the first week of June. In the closing week of July an offering by the Treasury of $200,000,000 of ⅝ths of 1 per cent two-year notes of the Commodity Credit Corporation was subscribed fourteen times, thus giving evidence of the keen appetite of the market for prime issues.

The volume of new corporate financing continues to show an encouraging increase, the July total of somewhat over $200,000,000 being the largest, save for June, of any month this year. As in earlier months most of the funds obtained was for refunding purposes, and the form of financing chiefly bonds and notes, although stock issues increased and at $42,000,000 reached the largest total since April.

Partly as a result of pressure for competitive bidding and smaller commissions, two large issues — $85,000,000 Shell Union Oil 15-year 2½s at 97¾ to yield 2.68 per cent, and $25,000,000 Southern Bell Telephone & Telegraph 40-year 3s at 107½ to yield 2.69 ($2,750,000 of this issue was reserved for the company's pension fund at 106) — were put out at prices that the market regarded as too high, and encountered slow distribution. This was something of a retarding influence upon the new issue market. Other issues, more conservatively priced, went well.

The Half Year's Profits

Reports published during the past month by 365 leading industrial corporations show combined net profits, less deficits, of approximately $397,000,000 for the first half year, which is double the $198,000,000 total reported by the same companies in the depressed first half of 1938, when earnings had fallen 69 per cent below the 1937 level and more than one-third of the companies were operating at a deficit. Capital funds of the group aggregated $11,220,000,000 at the beginning of this year, upon which the half year's profits were at an annual rate of 7.1 per cent, compared with a rate of 3.5 per cent on a slightly larger capital in the first half of last year.

Separate figures available by quarters for 290 of these companies show combined net profits of $188,000,000 for the second quarter of 1939, compared with $178,000,000 for the first quarter of 1939 and $96,000,000 for the second quarter of 1938.

The Trend of Business and Profits

A summary of our tabulation for the half year is given by major industrial groups. Financial results of these large companies, whose securities are listed on the stock exchanges and which publish statements promptly, indicate the trend of earnings, but are not fully representative of earnings of all companies, large and small, complete reports of which are not available immediately.

The second quarter of this year was similar to the first in showing marked recoveries in profits by most companies over those of a

PROFITS OF LEADING CORPORATIONS FOR THE HALF YEAR

Net Profits Are Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends. — Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

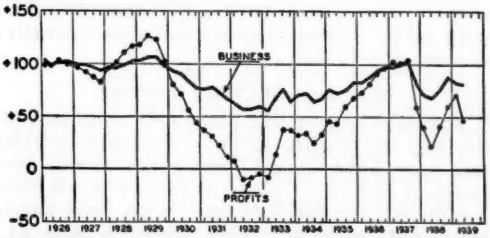
No.	Industrial Groups	Net Profits Half Year 1938	Net Profits Half Year 1939	Per Cent Change†	Net Worth January 1 1938	Net Worth January 1 1939	Annual Rate of Return % 1938	Annual Rate of Return % 1939
5	Baking	$ 8,891	$ 8,891	......	$209,659	$210,678	8.5	8.4
18	Food products—misc.	32,800	35,259	+ 7.5	629,105	652,378	10.4	10.8
12	Beverages	6,932	8,070	+16.4	111,642	126,096	12.4	12.8
16	Textiles and apparel	D-1,140	4,762	+	116,728	117,166	......	8.1
4	Shoes and leather	530	3,284	+	117,800	118,015	0.9	5.6
7	Wood products	D-845	D-184	......	70,242	68,444	......	......
14	Paper products	2,645	3,322	+25.6	163,039	162,878	3.2	4.1
26	Chemicals, drugs, etc.	42,801	75,530	+76.5	1,273,102	1,313,169	6.7	11.5
9	Petroleum products	20,367	12,770	—37.3	831,673	834,163	4.9	3.1
13	Stone, clay and glass	4,646	11,664	+	311,428	305,165	3.0	7.6
1	Iron and steel—U. S. Steel	D-6,303	1,970	+	1,592,212	1,298,907	......	0.3
31	Iron and steel—other	D-7,770	21,507	+	1,804,625	1,769,989	......	2.4
8	Building equipment	D-1,887	2,404	+	217,089	200,667	......	2.4
16	Electrical equipment	18,989	26,119	+37.5	609,646	611,985	6.2	8.5
12	Hardware, tools, etc.	1,390	2,948	+	80,259	79,757	3.5	7.4
9	Household equipment	1,603	2,363	+47.4	39,590	39,398	8.1	12.0
28	Machinery	5,263	11,034	+	243,177	241,480	4.3	9.1
5	Office equipment	6,362	6,702	+ 5.3	125,785	129,453	10.1	10.4
9	Railway equipment	D-109	3,336	+	195,416	193,338	......	3.5
6	Aircraft and parts	8,725	11,723	+34.4	79,564	95,210	21.9	24.6
13	Metal products—misc.	D-112	2,504	+	77,904	77,407	......	6.5
1	Autos—General Motors	33,020	100,993	+	992,305	1,027,817	6.7	19.7
6	Autos—other	D-2,472	D-1,562	......	56,344	52,412	......	......
21	Auto equipment	D-2,069	6,269	+	117,323	113,879	......	11.0
16	Misc. manufacturing	3,508	6,201	+76.8	118,427	120,311	5.9	10.3
306	Total manufacturing	175,765	367,879	+	10,184,084	9,960,162	3.5	7.4
11	Metal mining	10,399*	10,141*	—2.5	394,037	371,722	5.3	5.5
8	Coal mining	D-4,481*	D-3,351*	......	181,516	169,497	......	......
6	Mining, quarrying—misc.	6,215*	5,544*	—10.8	100,199	100,720	12.4	11.0
17	Trade	2,656	7,104	+	274,917	278,603	1.9	5.1
3	Amusements	7,350	8,357	+13.7	187,082	193,570	7.9	8.6
14	Service—misc.	317	1,649	+	147,856	145,292	0.4	2.3
365	Total	$198,221	$397,323	+	$11,469,691	$11,219,566	3.5	7.1

D- Deficit. * Before certain charges. † Increases or decreases of more than 100 per cent not computed.

year ago, or changes from deficits to profits. In the iron and steel, automobile and various machinery, equipment and building material industries, in which profits had dropped sharply or disappeared entirely last year, the recoveries shown by the tabulation this year are particularly striking.

There are still numerous individual companies, however, whose earnings, due to special conditions, continue seriously depressed. In the steel industry, the higher operating rate permitted many companies to reduce or eliminate their deficits, but rate of return on capital for the industry as a whole remained low because of the prevailing prices for steel products. Petroleum company earnings this year have in many cases been substantially lower than last year, although recently the margins between prices of crude oil and refined products have widened.

The longer-term trend of profits is indicated by the index in the accompanying chart, based upon rate of return of 200 large companies and adjusted for season variation. Preliminary figures show that profits by this group increased from the first quarter to the second by somewhat less than the usual seasonal extent, with the result that the adjusted index declined, as did the Annalist adjusted index of business activity.



Quarterly Index of Industrial Corporation Profits and The Annalist Index of Business Activity. 1926 = 100

Sales figures reported for the half year show, in most cases, gains of widely varying extent over those last year. Aggregate sales of 40 large manufacturing corporations, given in the attached list, increased from $1,800,000,000 to $2,106,000,000, or by 17 per cent, while sales of the retail trade group increased from $1,654,000,000 to $1,707,000,000, or by 9 per cent.

% Change in Half Year's Sales, 1938-1939

Manufacturing		Merchandising	
Air Reduction Co.	+15.0	American Stores Co.	+ 2.8
Allis-Chalmers Mfg.	—14.7	Barker Bros. Corp.	+ 2.7
Atlantic Refining Co.	— 2.9	Bond Stores	+17.5
Atlas Powder Co.	+ 0.7	Chicago Mail Order	+13.5
Beatrice Creamery Co.	— 4.2	Consol. Retail Stores	+ 6.1
Caterpillar Tractor Co.	+21.8	Crown Drug Co.	— 5.1
Cluett, Peabody& Co.	+11.8	Edison Bros. Stores	+ 3.0
Continental Bak. Corp.	— 4.9	Marshall Field & Co.	+ 2.8
Continental Oil Co.	— 1.2	M. H. Fishman Co.	+ 3.1
Continental Steel Corp.	+35.6	W. T. Grant Co.	+ 8.5
Crucible Steel Co.	+51.1	H. L. Green Co.	+ 9.9
E. I. du Pont & Co.	+29.4	Interstate Dept. Stores	+ 7.2
Endicott-Johnson Corp.	+23.8	Jewel Tea Co.	+ 2.0
Fairbanks, Morse	+ 8.6	G. R. Kinney & Co.	+ 8.4
General Electric Co.	+11.8	S. S. Kresge Co.	+ 4.6
General Foods Corp.	+10.2	S. H. Kress & Co.	— 0.7
General Motors Corp.	+41.4	Kroger Groc.& Bak.	+ 2.5
General Tire & Rub. Co.	+31.2	Lane Bryant, Inc.	+ 3.3
Hercules Powder Co.	+16.4	Lerner Stores Corp.	+ 5.3
Inter. Shoe Corp.	+12.9	McCrory Stores Corp.	+ 6.2
Johns-Manville Corp.	+ 7.8	McLellan Stores Corp.	+ 6.8
Kimberly-Clark Corp.	+ 4.1	Melville Shoe Corp.	+ 5.9
Lone Star Cement	+ 2.4	Montgomery Ward	+14.9
Mead Corporation	+ 1.5	G. C. Murphy Co.	+11.9
Minn.-Honeywell Reg.	+23.0	National Tea Co.	— 3.1
Natl. Cash Register	+ 8.1	Neisner Bros., Inc.	+20.3
Natl. Lead Co.	+17.6	J. J. Newberry Co.	+ 7.1
Otis Elevator Co.	—25.8	J. C. Penney Co.	+ 9.8
Phillips Petroleum	— 0.8	Peoples Drug Stores	+ 4.8
Quaker State Oil Ref.	—16.0	Reliable Stores Corp.	+13.7
Ruberoid Company	+14.1	Rose's 5-10-25c Stores	+ 3.6
Sharon Steel Corp.	+62.2	Safeway Stores, Inc.	+ 2.8
Shell Union Oil	— 4.4	Schiff Company	+ 8.0
Simmons Company	+12.5	Sears, Roebuck & Co.	+21.3
Standard Brands	+ 2.1	Spiegel, Inc.	+ 7.2
Sun Oil Co.	— 0.6	Sterchi Brothers	+17.5
United Aircraft	+13.0	Union Premier Food	+33.7
Wesson Oil & Snowdrift	—14.4	Walgreen Company	+ 6.0
Westinghouse Electric	+ 5.9	Western Auto Supply	+29.0
Wheeling Steel Corp.	+31.9	F. W. Woolworth Co.	+ 4.2

Merchandise inventories given on the balance sheets of 75 large corporations on June 30, 1939, or thereabouts totaled $523,000,000, which represented a decrease of approximately 7 per cent from the total on December 31, 1938. Compared with June 30, 1938, there was a decrease of 8 per cent (despite the much higher level of sales this year), and since June 30, 1937, a reduction of 21 per cent. Although these companies constitute only a small sample of industry and trade, their experience coincides with other evidence of generally conservative inventory policies.

Railroad and Utility Earnings

Railroad freight and passenger revenues, reflecting the higher level of business activity this year, have shown gains every month over those of last year. Gross revenues of all class 1 railroads for the half year, with June partly estimated, increased from approximately $1,636,000,000 to $1,797,000,000, or by 10 per cent. Net railway operating income rose from $70,000,000 to $181,000,000, and while it did not fully cover interest charges in either period, or provide any net return on capital funds of over $13,000,000,000 (for the class 1 systems considered as a whole), the net deficit was reduced from $181,000,000 to $88,000,000.

A group of 25 large public utility systems supplying electric light and power, gas and other services, reporting for the twelve months ended June 30, 1939, showed a rise of 2 per cent in gross operating revenues over those of a year previous, and a gain of 7 per cent in net income after charges.

The American Telephone and Telegraph Company and its principal telephone subsidiaries reported for the twelve months ended May 31, 1939, an increase of 2 per cent in gross operating revenues and 3 per cent in net income. This gain in net was made despite a further increase in taxes, which this year are running 84 per cent as large as the total net income applicable to subsidiary and parent company stocks.

Showing of Large and Small Companies

Referring to our earlier suggestion as to the need for caution in drawing conclusions as to business profits in general from the results of the larger corporations, we present the following table based on Treasury statistics for 1936, showing the earnings performance of all manufacturing corporations, numbering more than 85,000, classified according to size.

Earnings of All Manufacturing Corporations, 1936, by Total Assets Classes

	Total Assets Classes (Thousands of Dollars)				
	Under 50	50-1,000	1,000-50,000	Over 50,000	Total
Number of corporations	43,123	36,734	5,359	134	85,350
Gross receipts (Millions of Dollars)	2,116	13,240	22,817	17,216	55,378
Net worth Jan. 1, 1936 (Millions of Dollars)	372	5,631	17,126	14,482	37,611
Net profit after tax* (Millions of Dollars)	—27	367	1,480	1,230	3,049
% on receipts	—1.28	2.77	6.49	7.14	5.51
% on net worth	—7.26	6.52	8.64	8.49	8.11

Source: Compiled from Treasury Department "Statistics of Income" for 1935 and 1936. — Deficit. * Net profit after tax includes income from sales, other operations, investments, intercorporate dividends and tax-exempt interest.

It will be observed that companies having assets of less than $1,000,000 make up almost 94 per cent of the total number, although accounting for only 28 per cent of the total receipts from sales and other sources. In certain branches of manufacturing requiring heavy investment in plant and equipment, the detailed statistics show the proportion of sales represented by the small companies to be even lower, whereas in other branches, where capital requirements are small, the proportion is much higher.

The percentages of net profit to receipts and to net worth, given in the last two lines of the table, vary significantly as between the different size groups. Thus it will be seen that companies in the "under $50,000 asset" bracket operated, as a group, at a deficit, and that the percentage of profits on receipts and on net worth tended to rise rather consistently in each size bracket. Financial results of the

large and old-established manufacturing companies naturally are more favorable than those of small companies, taken as a group and including as they do many newly-established enterprises. Moreover, many small companies make a practice of paying out their earnings in the form of salaries, rather than dividends, because of tax advantages. In 1936 when 41,157 manufacturing corporations (or 48 per cent of the total) reported having no net income, 40,108 of such corporations were to be found in the size groups under $1,000,000. Taking the companies with assets above $1,000,000, only 19 per cent reported no net income.

Although corporations with assets under $1,000,000 handle only about one-fourth of the total sales in the manufacturing industries, nevertheless the many thousands of such concerns, whose plants are located in cities and towns in every part of the United States, are vital factors in the business activity, employment and tax receipts of their own communities. Their position is being made increasingly difficult by the rising trend of taxes, including social security taxes, and by the wages and hours law, under which minimum wage rates are to step up automatically on October 24th, unless this provision of the act should be amended.

Business Recovery Abroad

Abroad, the uptrend of business activity continues, prompted primarily no doubt by the enormous expenditures on national defense. That this is no sound basis for enduring recovery needs no emphasis here; nevertheless, while these vast expenditures are going forward their stimulating influence upon employment and production is undeniable. According to the last annual report of the Bank for International Settlements, issued in May, this year, world expenditures on armament have mounted sixfold since 1928, when they were already greater than in 1913, and the aggregate of budgetary deficits in the world covered by borrowing exceeds $1,000,000,000 a month, of which about a third is in the United States. Moreover, the figures are constantly increasing.

In Great Britain, the government's original estimate of £580,000,000 for defense needs this year is now swollen to nearly £750,000,000, of which about £500,000,000 will be met by borrowing. How rapidly the cost of the British arms effort is mounting is illustrated in striking fashion by the following table from the London "Economist" of July 8:

British Defence Expenditure, Including Issues Under Defence Loans Act*
(Millions of Pounds Sterling)

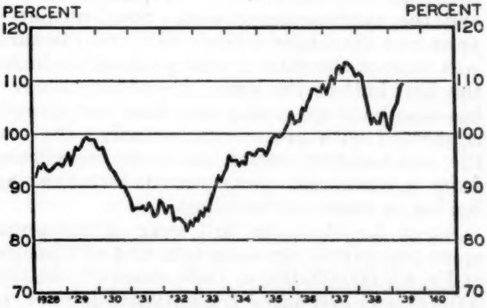
	1935-36	1936-37	1937-38	1938-39	1939-40
First Quarter	27.5	37.5	46.3	65.8	123.9
Second "	30.3	41.2	58.3	86.4	....
Third "	37.3	48.0	68.3	102.9	....
Fourth "	41.8	59.4	89.3	127.5	....

*British fiscal year April 1—March 31.

From the above it will be seen that the rate of spending during the first quarter of the British fiscal year was nearly double that of a year previous and nearly treble that of the first quarter of 1937-38. As the "Economist" points out, the first quarter's defense expenditure is invariably the smallest of the four, and the fact that the June quarter's total was this year within £4 millions of the record level of £127,500,000 reached in the previous quarter suggests the huge figures that will follow in succeeding quarters.

British Recovery Continues

With the entire nation embarked upon so gigantic a program, it is not surprising that British business indexes show a further rise. The successive alarms arising out of the international situation have indeed retarded business in some directions, which perhaps explains in part the failure of the "Economist's" general business index to record more than a small increase in May, following the vigorous rise of the earlier months of the year. However, other business indexes continue to make an impressive showing, and with the peak of government spending still to be reached, there seems little question but that British recovery is going ahead.



Business Activity in Great Britain.
Index of London "Economist."
(1935 = 100, latest figure May, 1939)

The output of steel in Great Britain established a new high record in May, which on a daily basis was exceeded in June. With but little capacity of active steel plants unutilized, deliveries for certain classes of materials are falling in arrears. Shipbuilding, aided by government subsidies to shipping and shipbuilding, has gained sharply, Lloyd's Register showing an increase of nearly 200,000 tons of merchant vessels under construction in the June quarter. Textiles, both in the cotton and woolen divisions, have benefitted substantially from government orders.

Employment figures give similar evidence of a broad uptrend in business, gains spreading into industries not directly affected by armament spending. In June the estimated number of insured persons in active employ-

ment reached on all-time record, and the number of unemployed continued to fall, with reports of local labor shortages becoming more frequent.

A suggestion of further expansion of business may be found in a considerable rise of raw material imports in May and June, a tendency which, unless counter-balanced later by increased exports, may exert some influence in the exchange market. For the month of June, the merchandise import balance amounted to £38,000,000, as against an average of £29,000,000 during the first five months of this year.

The Broadening of French Recovery

In France, also, business has shown important improvement, due partly to armament expenditures and partly to increased confidence engendered by the policies of the present Government. Since the failure of the general strike in November and the promulgation by the Government of the November decree laws modifying earlier legislation, including the 40-hour week, in a manner to permit increased production, the index of French industrial activity has risen about 15 per cent, to 89 (1929 = 100). Naturally, in view of the magnitude of armament expenditures, the greatest progress has been made in the heavy industries and the engineering trades. Steel output in June was the highest since 1930 and the same was true of the rate of coal production during the first half of the year. However, recovery has also been spreading into lines not directly connected with armament, including the textile and building trades, the latter benefitting from government measures undertaken last Spring to stimulate building.

As in England, the full force of the armament program is yet to be felt. Out of a budget of Fr. 137,000,000,000 in 1939, about Fr. 50,000,000,000 was estimated for national defense, or practically as much as the total ordinary revenues collected in 1938. Part of the cost will be borne by higher taxes, proceeds of which during the first six months of 1939 were Fr. 5,150,000,000 larger than in the same period of 1938, although slightly less than the estimates, and some Fr. 40,000,000,000 is expected to be raised by loans.

Possibly the most striking achievement by the French Government, however, has been its success in creating an atmosphere conducive to the repatriation of something like Fr. 20,000,000,000 of French capital during a period of great international tension. The effects of this have been far-reaching, — strengthening the position of the franc, making possible a reduction of interest rates in the French market and enabling the Treasury to carry through a program of consolidating the floating debt, thus paving the way for the heavy borrowing to come.

With the stability of the franc has come a better equilibrium in the price structure. Retail prices and cost of living rose only about 2 per cent since November, which is being counterbalanced by larger earnings resulting from extra hours worked. The 40-hour week has been widely modified, and in May a survey covering over 8,000 factories revealed 35 per cent of the workers employed more than 40 hours, as compared with only 2 per cent in May, 1938. Moreover, the number of unemployed in June, 1939, was actually smaller than in June a year ago, despite confident predictions to the contrary by many who opposed the policy of extending the working hours per week when it was adopted last Fall.

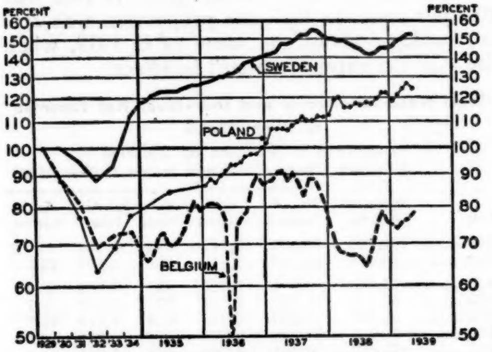
The greater price stability, together with reduction of costs made possible by extension of working hours, has enabled French exporters to realize, somewhat belatedly, upon the competitive advantage of currency depreciation; and a decline in German and Czech competition has also been helpful. French exports, which had increased 28 per cent in value in 1938 over 1937, gained another 29 per cent during the first six months of this year over the corresponding period of last year, while the excess of imports dropped from Fr. 9,292,000,000 to Fr. 6,726,000,000, a level which, according to the Minister of Commerce, "makes the support of the franc easy and is lower than the import surplus in the best post-war years." Also, due to the cheap cost of living and the disturbed conditions in Central Europe, France is attracting more tourists, which is contributing further to improvement in the balance of payments, already calculated to have reached an equilibrium in 1938.

The Situation Elsewhere

While the most pronounced gains have been in Great Britain and France, indications of improvement have not been lacking in other quarters. Within the past few months the activity of the British steel industry has brought an overflow of orders into Belgium, with a consequent stimulation of Belgian steelmaking and coal-mining, though as yet the effects have not been spread generally through the Belgian economy. Scandinavian countries, which participated but mildly in the 1938 depression, are now feeling the effects of the revival of the British market, especially as regards wood pulp and timber, the latter being in demand for building, including the construction of army huts and air-raid shelters.

In Holland, which was more severely hit by the depression by reason of its interest in international trade, shipping and foreign investments, business has likewise recorded some improvement, aided by increased tariff protection on home industries, some recovery in foreign trade and large public works initiated by the government. In all these countries, it is

necessary to interject, arms spending has been on the increase, the national defense budget of Holland rising from about Fl. 85,000,000 in the years before 1936 to Fl. 234,000,000 in 1939. In Germany and Italy and in the Far East, Japan, the internal economies, as is well known, have been working under high pressure, though owing to shortage of foreign exchange and policies of self-sufficiency, the influence of their activity upon world trade has been much reduced.



Indexes of Industrial Production in Sweden, Poland and Belgium
(Source: League of Nations Bulletin, 1929 = 100)

Raw material producing countries continue, as a general rule, to contend with low prices for basic commodities, which have curtailed external purchasing power, though in many cases internal activity has been maintained on a relatively high level by reason of development of local industries and national policies looking towards self-containment. With a continuance of recovery in the principal raw material consuming countries, notably the United States and Great Britain, it is reasonable to suppose that the position of the producing countries will be favorably affected.

There are, of course, certain exceptions to the general situation in raw material producing areas that ought to be mentioned. South Africa, for example, has continued to enjoy prosperity by reason of the importance of the gold mining industry, which reached a new high level of output this year. Also, it is interesting to note that exports of British India have been increased this year by the demand for jute and jute products, chiefly for the making of sandbags, while burlap prices have risen sharply to the peak reached in 1937.

Possibly the most important exception, however, to the general situation of raw material producers has been Canada, where foreign demand for non-ferrous metals sent mining activity to record levels, almost 90 per cent above 1929. Canadian general industrial activity, by reason of busier construction, larger shipments of newsprint and an upswing in heavy industry, recovered by May most of the ground lost since last Fall. A good tourist season and the most favorable moisture conditions in the prairie provinces in about ten years have contributed to the more satisfactory outlook. The current wheat crop is estimated at about 450,000,000 bushels, or 100,000,000 bushels more than harvested last year. Since the carryover of wheat is also large, Canada will have this year one of the largest exportable surpluses of wheat in Canadian records, amounting to about 480,000,000 bushels.

Contrasting Trends in Business and Stock Prices

An unusual feature of the recovery of business now in evidence in Great Britain and France, and to a lesser extent in some other countries, is the contrast afforded between the trends in business and in the stock markets. Whereas a recovery of the proportions now apparently under way in Great Britain might normally be expected to inspire enthusiastically advancing share prices, the fact is that trading has been dull, without pronounced trend in prices, and much the same conditions prevail in continental markets. Evidently the ever-present spectre of possible war, the high and rising taxation, and the prospect of increased governmental control of profits and of industry in the interests of national defense have damped down the usual speculative accompaniment of increasing business volume.

In London, the gilt edge market has likewise been under the cloud of war fears and has been influenced, in addition, by the prospect of heavy government borrowing later this year. A suggestion of the extent to which British government requirements have dominated the economic situation appears in the fact that notwithstanding the pronounced pickup in industrial activity this year, the new capital market has been experiencing the dullest period since the war, with the total new issues during the first five months of this year only about half the total of the same period a year ago.

The Rise of Income and Other Taxes

The recent summary by the Treasury Department of individual income tax returns, filed last year and covering 1937 incomes, shows the effect of the sharply rising tax rates of recent years, particularly upon the higher incomes, which heretofore have provided substantial savings and new equity capital for business.

Returns showing net income in 1937 were filed by 6,350,148 individual or family groups, of which 3,371,443 were taxable and 2,978,705 nontaxable. The number of taxable returns was higher than for any year since 1924, but the increase was concentrated in the lower income classes. In the higher income classes, the number decreased in 1937.

Aggregate net income shown on the 1937 returns was approximately $21,239,000,000, an

increase of $1,998,000,000 over 1936 and divided as follows:

Individual Net Income, by Income Classes, in 1937

Income Class	Net Income Before Taxes (In Millions of Dollars)
Over $100,000	$ 862
$25,000 - $100,000	2,144
$5,000 - $25,000	5,810
Total over $5,000	8,816
Under $5,000 (reported)	12,423
TOTAL (reported)	$21,239

As the total national income paid out to individuals in 1937 has been estimated by the Department of Commerce at $69,330,000,000, the indicated portion received by persons with incomes of less than $5,000 (some of whom file returns, but most of whom do not) was $60,514,000,000, or 87.3 per cent of the total. In 1936 the corresponding figure was 85.8 per cent, and in 1929 only 78.8 per cent.

Trend of Larger Incomes

A feature of the personal tax returns during recent years has been the limited recovery made by the larger incomes, following the severe decline during 1929-32. The accompanying diagram and table, prepared from official figures, summarize from 1919 through 1937 the national income and the individual net incomes of over $25,000.

It will be observed that the aggregate of net incomes over $25,000 in 1937 was far below 1929, and was substantially below earlier years back to 1923, when both the population and the national income were smaller. Although the national income in 1937 had risen to about the 1925 level, the number of incomes over $25,000 was 39 per cent less, and their combined net income was 48 per cent less.

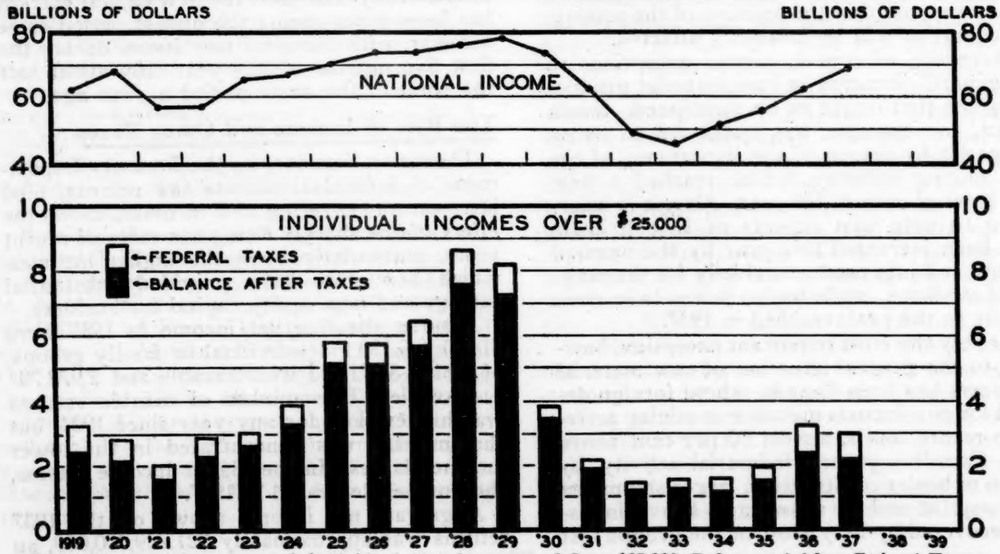
Moreover, federal income taxes payable by this group in 1937 were much larger than in 1925, due to the sharp increase in surtax rates, as well as higher normal tax rates, lower personal exemptions and smaller permitted deductions and credits. In 1925, the surtaxes started at $10,000, before personal exemptions, and ranged from 1 per cent up to a maximum of 20 per cent, but in 1937 (and since) the surtaxes started at $4,000, after personal exemptions, and ranged from 4 per cent up to a maximum of 75 per cent. The proportion of incomes over $25,000 taken by federal taxes in 1925 was 10.9 per cent; in 1937 the proportion was 26.9 per cent, or about the same as in 1919, when the war tax rates were still in effect.

Total National Income and Individual Net Incomes of Over $25,000

(Amounts in Millions of Dollars)

Year	Estimated Total National Income	Federal Individual Returns of Over $25,000: No. of Returns	Net Income	Federal Taxes	Bal. After Taxes	Tax to Net Inc.
1919	$62,945	56,323	$3,344	$884	$2,460	26.7%
1920	68,434	54,290	2,845	639	2,206	22.5
1921	56,689	40,015	2,025	431	1,594	21.3
1922	57,171	51,509	2,906	572	2,334	19.7
1923	65,662	56,466	3,099	424	2,675	13.7
1924	67,003	68,592	3,905	550	3,355	14.1
1925	70,051	90,239	5,769	628	5,141	10.9
1926	73,523	87,589	5,728	626	5,102	10.9
1927	73,966	93,818	6,420	724	5,696	11.3
1928	75,904	111,232	8,636	1,045	7,591	12.1
1929	78,556	102,578	8,189	928	7,261	11.3
1930	73,290	60,692	3,875	400	3,475	10.3
1931	62,032	35,322	2,128	195	1,933	9.2
1932	49,024	26,218	1,406	201	1,205	14.3
1933	45,317	26,495	1,498	248	1,250	16.6
1934	51,510	28,931	1,534	350	1,184	22.8
1935	55,137	36,709	1,993	465	1,528	23.3
1936	62,586	59,476	3,288	898	2,390	27.3
1937	69,330	55,416	3,006	810	2,196	26.9

Compiled from Treasury Department "Statistics of Income" for 1936, Part I, and press release for 1937. Total national income paid out as computed by Department of Commerce, 1929-37, and by National Industrial Conference Board, 1919-28.



Total National Income, and Individual Net Incomes of Over $25,000, Before and After Federal Taxes.

Effect on Venture Capital

Heretofore, as incomes rose above the average level, they provided an increasing margin available for savings, which under normal conditions was invested promptly in business, either through the purchase of stocks, bonds, mortgages, real estate, etc., or through financial institutions. Most businesses are originally established by an individual who invests his own savings, and often obtains financial assistance from relatives and friends. In the providing of "risk capital" — such as for expansion of small but promising new enterprises, development of new inventions, construction of new building, financing untried or speculative ventures generally — the individual investor willing to use a portion of his own money for such purposes has a latitude that properly is denied to banks, insurance companies and other institutions, which handle the funds of others and are subject to strict supervision.

In recent years this flow of larger incomes has declined materially, and the balance available after taxes has declined still more. At the same time, as has been agreed by tax experts, the prevailing high surtax rates on larger incomes, also the treatment of capital gains and losses, tend to penalize rather than encourage the taking of business chances. In the higher brackets, the gross yield from ordinary business investments is so scaled down by surtaxes that the net yield is less than that obtainable from state and municipal bonds. If a venture proves successful, a large share of the profit must be paid in taxes, but should there be a loss instead, it may be deductible only to a limited extent.

A serious incidental effect of the decline in larger incomes has been the curtailment during recent years in the gifts and bequests to colleges and universities, churches, hospitals and charities. Former donors to such organizations have seen their incomes sharply reduced, and their taxes increased. They not only have less income available for giving away, but their uncertainty as to the future naturally prompts them to hold larger and more liquid reserves for their own later years, the security of their dependents and the payment of death taxes. Endowment funds have had a decrease of their income from investments also, due to the decline in interest rates, reduction of dividends, default of bonds and mortgages and depreciation of real estate.

Taxes and National Income

Although federal income taxes have an important influence upon the larger incomes, and thereby upon the flow of capital into industry, they are not an accurate measure of the total burden of taxes upon business and the public. Last year, out of a total population of approximately 130,000,000, with an estimated 40,000,000 gainfully employed, the number of taxable returns filed was but 3,371,443. Total tax liability amounted to $1,142,000,000, the major part of which was paid from the larger incomes. Thus while there were 3,316,027 taxpayers with incomes below $25,000, who paid a total of $332,000,000 or an average of about $100 apiece, the 55,416 taxpayers with incomes over $25,000 paid a total of $810,000,000, or an average of $14,600 apiece.

Individual income taxes accounted for only 18 per cent of revenue receipts in the fiscal year just closed, the remainder coming from corporation income taxes, excise taxes, social security taxes, customs and miscellaneous sources. Of the total expenditures, individual income taxes covered only 11 per cent, and revenue receipts but 61 per cent, the remainder being financed by borrowing.

Probably the best measure of the tax burden upon business and upon the standard of living is the relation of total taxes (federal, state and local) to total national income. This is summarized in the accompanying table, based on figures computed by the National Industrial Conference Board.

Tax Collections and National Income in the United States

Year	Tax Collections (Millions) Federal	State & Local	Total	Taxes per Capita	National Income (Millions)	Taxes to Natl. Income
1926....	$3,207	$ 5,398	$ 8,605	$73.84	$73,523	11.7%
1927....	3,337	5,722	9,059	76.64	73,966	12.2
1928....	3,194	6,148	9,342	77.94	75,904	12.3
1929....	3,328	6,431	9,759	80.30	79,498	12.3
1930....	3,468	6,798	10,266	83.40	72,398	14.2
1931....	2,717	6,583	9,300	74.93	60,203	15.4
1932....	1,789	6,358	8,147	65.19	46,708	17.4
1933....	1,786	5,715	7,501	59.64	44,713	16.8
1934....	2,892	5,881	8,773	69.28	51,560	17.0
1935....	3,546	6,185	9,731	76.31	56,254	17.3
1936....	3,847	6,651	10,498	81.74	65,246	16.1
1937†..	5,029	7,271	12,300	95.16	69,419	17.7
1938†..	5,936	7,764	13,700	105.21	62,286	22.0
1939†..	5,414	—	—	—	—	—

Source: National Industrial Conference Board studies on Cost of Government and National Income. Tax refunds are excluded from collections. †Preliminary.

It will be seen that the ratio of total taxes to realized national income has risen from 11.7 per cent in 1926 to 22 per cent in 1938, when it was higher than in any other year for which records are available. Total tax collections last year reached a new high of $13,700,000,000, equal to about $105 per capita of population and $317 for each employed person. If taxes were raised sufficiently to cover fully all government expenditures and bring an end to deficit financing, the tax charge (without provision for debt amortization) would be still higher.

The National City Bank of New York

Head Office · 55 WALL STREET · *New York*

Condensed Statement of Condition as of June 30, 1939

INCLUDING DOMESTIC AND FOREIGN BRANCHES

ASSETS

Cash and Due from Banks and Bankers		$ 824,543,860.39
Gold Abroad or in Transit		1,732,922.74
United States Government Obligations (Direct or Fully Guaranteed)		626,450,839.47
Obligations of Other Federal Agencies		56,106,026.61
State and Municipal Securities		80,524,734.46
Other Securities		76,084,944.00
Loans, Discounts and Bankers' Acceptances		488,144,877.68
Real Estate Loans and Securities		8,798,219.46
Customers' Liability for Acceptances		12,472,688.93
Stock in Federal Reserve Bank		3,735,000.00
Ownership of International Banking Corporation (Including Paris Office)		8,000,000.00
Bank Premises		44,705,142.35
Other Real Estate		656,100.68
Other Assets		818,434.39
Total		$2,232,773,791.16

LIABILITIES

Deposits		$2,062,823,358.98
Liability on Acceptances and Bills	$32,822,478.75	
Less: Own Acceptances in Portfolio	15,796,830.94	17,025,647.81
Items in Transit with Branches		1,856,785.92
Reserves for:		
Unearned Discount and Other Unearned Income		4,000,616.11
Interest, Taxes, Other Accrued Expenses, etc.		5,797,196.00
Dividend		3,100,000.00
Capital	$77,500,000.00	
Surplus	47,000,000.00	
Undivided Profits	13,670,186.34	138,170,186.34
Total		$2,232,773,791.16

Figures of Foreign Branches are as of June 24, 1939.

$57,860,537.72 of United States Government Obligations and $25,611,710.69 of other securities are deposited to secure $58,647,977.05 of Public and Trust Deposits and for other purposes required by law.

(Member Federal Deposit Insurance Corporation)

City Bank Farmers Trust Company

Head Office · 22 WILLIAM STREET · *New York*

Condensed Statement of Condition as of June 30, 1939

ASSETS

Cash and Due from Banks	$35,356,209.97
United States Government Obligations (Direct or Fully Guaranteed)	24,921,066.52
Obligations of Other Federal Agencies	3,807,587.45
State and Municipal Securities	5,689,485.24
Other Securities	2,769,380.65
Loans and Advances	5,016,592.61
Real Estate Loans and Securities	7,392,618.26
Stock in Federal Reserve Bank	600,000.00
Bank Premises	4,072,376.25
Other Real Estate	550,039.79
Other Assets	1,675,556.68
Total	$91,850,913.42

LIABILITIES

Deposits	$63,283,811.62
Reserves	3,942,092.18
Capital	10,000,000.00
Surplus	10,000,000.00
Undivided Profits	4,625,009.62
Total	$91,850,913.42

$1,520,000.00 of United States Government Obligations are deposited with public authorities for purposes as required by law.

(Member Federal Deposit Insurance Corporation)

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